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April 25, 2005

VIA ELECTRONIC MAIL

Federal Trade Commission
Office of the Secretary
Room 159-H (Annex Z)
600 Pennsylvania Ave., N.W.
Washington DC, 20580

Re: FACT Act Scores Study
FTC File No. P044804
RIN [3084-AA94]

Ladies and Gentlemen:

The American Insurance Association ("AIA") submits these comments in response to the February 17, 2005, notice and request for public comment regarding the effects of credit scores and credit-based insurance scores on the price and availability of various financial products and services.

Founded in 1866, AIA is a national trade association of leading property and casualty insurance companies, representing over 435 insurers that provide insurance throughout the United States and the world. Because many of our members use credit-based insurance scores in their business operations, they have a stake in this study and its outcome. Moreover, they have practical experience with the use of credit-based information and how it positively affects insurers and insureds alike.

A. Overview

As the answers to the questions below indicate, there are significant benefits to the use of credit based insurance scoring that accrue to all participants in the marketplace, especially consumers and insurers. These benefits include more accurate risk assessment, underwriting and pricing, greater choice of price and product suppliers for consumers and reduced overhead costs. Beyond their marketplace value, the benefits are also entirely consistent with the purposes and provisions of the state and federal regulatory laws that govern insurers' activities, including those specifically regulating credit based insurance scoring.

While the following comments respond to the specific questions posed with respect to credit-based insurance scores it must be kept foremost in mind that independent studies, including those led by insurance regulators, have repeatedly found that the use of credit-based insurance scores is non-discriminatory and beneficial. The EPIC Actuaries, Alaska and, most recently, Texas studies have all reached these same fundamental conclusions. As the Texas Department of Insurance Commissioner recently stated in a letter to the Texas Legislature regarding insurer use of credit-based insurance scores: "[C]redit scoring significantly improves pricing accuracy when combined with other rating variables in predicting risk..." and, "its use is justified actuarially and it adds value to the insurance transaction." These conclusions stand to reason given that credit related activities reflect reliability and, yet, are "blind" to impermissible factors such as a person's race or ethnicity. It is our view that the following information will help the FTC in reaching the same conclusions.

B. <u>Credit-Based Insurance Scores and Property and Casualty Insurance</u>

The following comments respond to the second part of the Federal Register Notice directed at insurance.

1. Specifically, how are credit-based insurance scoring models developed?

Credit-based insurance scoring models are developed by vendors such as Fair-Isaac as well as personal lines insurance companies. A host of statistical methodologies are used to develop these credit-based insurance scoring models. These include multivariate regression, general linear models, neural networks and tree algorithms. The data that are used include data from the credit files and Personal Lines insurance loss and exposure or premium information. The credit factors that are commonly used include items that measure payment history including delinquencies, adverse public notices (liens, and foreclosures), collections, credit usage (balance ratios), accounts/trade lines opened and inquires made on the credit file. These factors are used because they have been found to be correlated with Personal Lines insurance losses.

Typically, credit-based insurance scoring models are developed by a modeler or team of modelers, who are experts in areas such as statistics, numbers, and algorithmic models, and who are charged with developing a "credit score" that best predicts a certain outcome (e.g.,: likelihood to open a new account, bankruptcy, insurance loss, default of 60 days or more within 12 months or within 24 months, etc.). They will review hundreds of variables found in a credit report to determine which are the most predictive. The beta scores are then run through a "regression analysis" on a sample group of data and against other risk factors to determine how well the model worked – i.e. did it predict loss propensity better than the previous tools applied to the same book of business. The results of the modeling are then reviewed to assure compliance with professional actuarial and legal standards.

Who develops credit-based insurance scoring models?

As stated above, a modeler or team of modelers who are experts in statistics, numbers and algorithms develop the models. A few companies are in the specialized business of developing scoring models and many businesses have in-house teams to develop credit-based scores. The results of the modeling are then reviewed to assure compliance with professional actuarial and legal standards.

What data and methodologies are used to develop credit-based insurance scoring models?

Data from credit reports are used to develop credit-based insurance scores and are a component for all manner of other "credit scores" used in the financial services industry. The methodologies used to develop credit-based insurance scoring models are scientific, proven, objective and fact-based. Using the "Law of Large Numbers" as a cornerstone in developing a scoring model, modelers are able to detect patterns that arise from millions of records and this analysis provides powerful predictive value.

What factors are used in credit-based insurance scoring models?

There are many factors available to a modeler and which span industry segments (i.e. variables for types of credit cards like bank cards, retail cards) or categories (i.e. variables based on all loans, such as automobile and home equity). AIA members have identified numerous variables that are typically used, to the extent permitted by law, in credit-based insurance models, including:

- Adverse public records such as judgments, foreclosures and liens. A typical variable for this might be the number of adverse public records.
- Account payment information - Sometimes these variables are framed in terms of negative events such as late payments or delinquencies - frequency, length of delinquency. A typical variable for this might be number of accounts delinquent 30 days or more. Other times these are framed in terms of positive events such as number of accounts paid on time. A typical variable for this might be number of satisfactory (paid on time) trade lines.
- Balances in relation to credit limit. A typical variable for this might be balance ratios (ratio of balance due to credit limit). Another typical variable for this might be instances where balance exceeded the credit limit for a particular account.
- Inquiries. A typical variable for this might be number of consumer initiated (and non-insurance) inquiries.
- Number of opened accounts.
- Age of oldest account (or trade line).

While sometimes these variables are limited to specific types of accounts such as automotive related or retail accounts, these factors are similar to factors used in more general credit scoring models. This should come as no surprise given that these are "credit-based" insurance scoring models

For example, though there are a host of subcategories within each, Fair Isaac identifies five general variables that "credit scores" are based on -- payment history, amounts owed, length of credit history, new credit, and types of credit used. For the payment history factor, subcategories in Fair Isaac scoring models include:

- Account payment information on specific types of accounts (credit cards, retail accounts, installment loans, finance company accounts, mortgage, etc.)
- Presence of adverse public records (bankruptcy, judgments, suits, liens, wage attachments, etc.), collection items, and/or delinquency (past due items)
- Severity of delinquency (how long past due)
- Amount past due on delinquent accounts or collection items
- Time since (recency of) past due items (delinquency), adverse public records (if any), or collection items (if any)
- Number of past due items on file
- Number of accounts paid as agreed

Why are those factors used?

Factors are used for their ability to assist in predicting particular outcomes, such as insurance loss. While no single factor or variable is necessarily predicative in isolation, when seen in large numbers like those used in modeling, they can establish patterns and provide predicative value that, in the insurance context, enables risks to be assessed and/or properly priced. More precise pricing enables insurers to accept greater risk by ensuring that both good risks and more marginal risks are properly priced to reflect the exposure they represent. Given the conclusions of the Epic Actuaries, Alaska and Texas studies, it is beyond reasonable dispute that, as the Texas Department of Insurance Commissioner recently stated: "[C]redit scoring significantly improves pricing accuracy when combined with other rating variables in predicting risk..." and, "its use is justified actuarially and it adds value to the insurance transaction."

What other factors have been considered for use in credit-based insurance scoring models, but are not used?

A modeler or person who has developed a scoring model is in the best position to explain what kinds of factors have been considered, but subsequently rejected. Again, however, generally speaking, if a factor/variable is not predictive or less predictive than other variables, for a particular outcome such as predicting insurance losses or not permitted by law, then it will not be used in a score as it would either be illegal or not aid an insurer in assessing and properly pricing risk. Moreover, as these are "credit-based" scores, Fair Isaac, ChoicePoint or other companies which have their own models may be in the best position to explain modeling and the factors chosen and rejected for credit scoring.

Why are those other factors not used?

Non-predictive, weak or legally prohibited predictive factors are not used. The goal of a scoring model/credit score is to find credit-related variables that have loss-predictive value, allowing insurers to more accurately assess and price risk.

Are there benefits or disadvantages, either to insurers or consumers, from the use of particular factors by credit-based insurance scoring models?

Yes. If a non-predictive or less predictive factor for loss is in a model, it will not perform as well and the benefits to insurer and insured decrease. However, a score typically is the "best it can be" because of the exhaustive time and cost involved to develop and refine it for its intended purpose--assessing risk. Thus, not surprisingly, insurers are sensitive to the competitive advantages they each believe they derive from their own modeling or use of insurance scoring models and its intellectual property value. TransUnion, a national credit reporting company, states the following about credit scoring models and credit scores on its Web site:

> "Credit scoring models translate the contents of a credit report into a credit score, a numerical value that represents overall creditworthiness. Because a credit score is simply a snapshot of a credit report at the time the score was calculated, credit scores may change to reflect changes in the report.
>
> There are a wide variety of credit scores available and each lender may use a different score, or give more or less weight to the one they use in relation to other factors. As a general rule, however, the higher a credit score is, the more trust a business will have in that customer's future performance.
>
> Credit scoring models help businesses make faster, more consistent and more precise predictions of how a prospect or customer will behave in a variety of different situations. For example, certain scores predict likelihood of response, while others predict future credit behavior, such as likelihood of paying as agreed, potential revenue an account will generate, and more. "

On the issue of the efficacy and impact of individual factors used in credit scoring models, a 2000 study by James Monaghan titled "The Impact of Personal Credit History on Loss Performance in Personal Lines," is an important contribution to the literature because the study addresses credit variables from a number of angles.[1] The study performs a number of univariate studies comparing individual credit variables used in models such as Amounts Past Due, Derogatory Public Records, Collection Records, Age of Oldest Trade, Number of Inquiries, Account Limits, and Balance-to-Limit Ratios with fitted loss ratio relatives. In each case, there exists a positive correlation between the component factor and insurance losses. This analysis is helpful in that it disaggregates a credit score into it component variables. It

[1] Monaghan, J.E., "The Impact of Personal Credit History on Loss Performance in Personal Lines," CAS Forum, Casualty Actuarial Society, (2000).

helps to illustrate that the relationship between credit scores is not entirely the result of some mysterious or proprietary interaction of the component credit variables. Instead, each of the component variables is individually somewhat predictive of insurance losses.

2. How many different credit-based insurance scoring models are in use today?

We do not have exact figures on the number of models, given the wide variety of models used today; moreover, models are constantly being created, refined and phased out. We do know, for instance, of reports that insurers submitted 40 models to regulators in Virginia when that state was studying credit-based insurance scores.

TransUnion's Web site states that: "There are literally thousands of score models used in the credit industry which consider different variables for different types of credit. Credit bureaus offer several different types of scores in their product portfolio, appealing to the vast array of creditors and credit applications in the country." So, it is safe to say there are many models.

Who offers credit-based insurance scores?

There are two major vendors of credit-based insurance scores, Fair Isaac and ChoicePoint. Additionally, there are a host of other companies offering credit-based insurance scores and other loss forecasting tools, as well as internal business units of insurers that "offer credit-based insurance scores."

3. How are credit-based insurance scores used?

Credit-based insurance scores are part of a complex, multi-layered risk evaluation system and process to assess and/or price a particular risk. Credit-based insurance scores are used in many ways, including pricing, inception underwriting, renewal underwriting, coverage options and bill payment plans availability, as permitted by law. They are very widely used by automobile and homeowners insurance companies. Credit can be used either for "underwriting" decisions--evaluating whether to accept or reject a risk or how to place it within the overall book of business perhaps in a preferred category, for example, or as a rating element, similar to traditional rating elements such as annual mileage, vehicle usage or rating territory.

Who uses credit-based insurance scores, and how widely are they used?

Insurers use credit-based insurance scores to evaluate personal and commercial risks. While use varies by market or state, it is clear that a substantial majority of insurers use credit-based insurance scoring. For example, in Illinois, according to the Department of Insurance, the percentage of "active, standard or preferred-risk companies that use credit make up 87% of the active, standard or preferred-risk market share." In Michigan, roughly two out of every three insurers licensed to do business in the state use credit. According to Fair Isaac in its written testimony on "The FCRA and How it Functions for Consumers and the Economy" before the a U.S. House or Representatives subcommittee in June 2003, "Over

350 insurance companies use Fair Isaac insurance scores that they obtain through national credit reporting agencies." So, credit-based insurance scores are a widely used way to measure and to determine appropriate premiums.

Nonetheless, decision makers must keep in mind that not all insurers use them in same way and many insurers have chosen not to use them at all. Thus, insurance consumers may shop amongst many insurers if they want one that does not use credit-based insurance scores or, perhaps, uses them in a limited fashion. For example, the Michigan Office of Financial and Insurance Services, has lists identifying many insurers that do not use credit-based insurance scores for auto and homeowners coverage. Lists of these insurers can be found at http://www.michigan.gov/cis/0,1607,7-154-10555_12902_15784-111965--,00.html

How do they fit into the underwriting and rating process for automobile and homeowners insurance?

Credit-based insurance scores are a critical component of underwriting and rating for those insurers who use this modeling, as they are a highly predictive indicator of risk. While no single factor or variable is necessarily predictive in isolation, when seen in large numbers like those used in credit-based insurance score modeling, these models establish patterns and provide predicative value that enables risks to be assessed and/or properly priced. For these insurers, the use of credit-based insurance scores fits into underwriting and rating because it allows more precise pricing that enables insurers to accept greater risk by ensuring that both good risks and more marginal risks are properly priced to reflect the exposure they represent. Given the conclusions of the Epic Actuaries, Alaska and Texas studies, it is beyond reasonable dispute that, as the Texas Department of Insurance Commissioner recently stated: "[C]redit scoring significantly improves pricing accuracy when combined with other rating variables in predicting risk..." and, "its use is justified actuarially and it adds value to the insurance transaction."

It is also important to recognize that the improved pricing derived from credit-based insurance scoring actually helps avoid subsidization and unfair pricing. Subsidization is basically when some insureds underwrite the premiums of others; in other words, pricing does not accurately reflect actual risk. As Mike Miller, one of the authors of the Epic Actuaries study recently observed for companies using credit-based insurance scoring, "The knowledge that credit-based insurance scores are related and predictive of insurance losses, means that rates established without reflection of credit scores will be inadequate for some insureds, excessive for other insureds, and unfairly discriminatory for all." While prefect premiums can only exist in a perfect world, insurers strive for the most accurate premiums, and credit-based insurance scores help those insurers that choose to use them.

The use of credit-based insurance scores also fits into underwriting and rating as it has increased the overall availability of automobile and homeowners insurance because it has increased confidence that insurers have in predicting losses. That increased confidence has encouraged insurers to offer and compete in market segments that they were reluctant to compete in previously. For example, prior to scoring, one AIA member reports that it was primarily a writer of so-called "preferred risks," with a small amount of standard-type business. That same company estimates that it could quote only about approximately 60% of its total auto insurance applicants at that time. However, by using credit-based insurance scores, and the broader pricing range it has created, this company now can offer quotes to over 95% of ***ALL*** auto applicants in most states. Another AIA member reports that, since the adoption of credit-based insurance scores, it is now able to offer approximately double the percentage of applicants coverage that it used to offer coverage to before the use of insurance scores.

The massive multivariate study by EPIC Actuaries of 2.7 million policies showed that insurance-based credit scores consistently ranked among the top two or three most important risk factors for all components of auto insurance coverage-bodily injury liability, personal injury protection, medical payments, property damage liability, collision and comprehensive. Credit scores were in fact found to be a better predictor of future risk than motor vehicle records, which have historically underreported driving-related violations and arrests.

A key finding was that there is a linear relationship between credit scores and the propensity for future auto insurance losses. Policyholders with the lowest credit scores of 607 or less, cost insurers 33% more to insure for a key benchmark coverage, on average, while those with the highest scores cost auto insurers 19% less to insure. The following table from the EPIC Actuaries study illustrates the correlation between scores and auto insurance losses on the benchmark coverage of property damage liability.

Indicated Relative Pure Premium (Cost to Insure) By Insurance Score

Score	Percent Above or Below Average Cost
No Hit/Thin Credit File	+ 9%
Less than 607	+33%
608-659	+18%
660-692	+10%
693-721	+ 3%
723-748	0%
749-774	- 7%
775-802	-11%
803-837	-14%
838-894	-15%
895+	-19%

Several insurers recently confirmed this strong predictive effect and the correlation between credit-based insurance scores and losses in affidavits filed as part of a lawsuit in Michigan. One insurer, for example, reported that its Michigan insureds with the highest insurance scores had an incurred loss ratio of 76.9% and a frequency of 20 claims for every

100 cars insured, while those who had the lowest scores had an 85.9% incurred loss ratio and a frequency of 28 claims for every 100 cars insured.

Another insurer in the Michigan litigation reported that its Michigan auto insured with credit-based insurance scores of 813 or greater had a cumulative loss ratio of 31.63%, while those with lower scores, 453 or less, had a cumulative loss ratio of 44.56%. The loss ratio was more dramatic for that insurer in Michigan homeowner's coverage, where insureds with a score of 817 or more had a cumulative loss ratio of 17.47%, while those with a score of 459 or less had a 31.86% ratio.

Another insurer in the Michigan litigation, who uses a system where better credit-based insurance scores are reflected with a lower number, reported "a clear and direct correlation between insurance scores and risk." For example, Michigan auto insureds with a 0 - 70 score had "adjusted pure premium"[2] of approximately $90 for bodily injury and property damage liability coverage, while insured with scores of 156 or greater had adjusted pure premium of approximately $250.

Yet another insurer's model, in which better scores are reflected by a high number, similarly demonstrated the correlation between scores and risk over several years. That company found that Michigan insureds with a score of 875 or greater had a 49% Loss Ratio while insureds with a score of less than 590 had an 87% Loss Ratio, nearly 80% higher!

Finally, another insurer in the Michigan litigation reported on how it conducted a "look back" study on its book of business with the assistance of Fair Isaac prior to using insurance score premium discounts at all. That study examined claims actually filed by its Michigan insureds. The study "validated the use of insurance score discounts by conclusively demonstrating that, among our insureds, persons with high insurance scores had lower loss ratios than persons with low insurance scores." This study for homeowner insureds found, for example, that for those with high insurance scores, the company only paid $.57 in losses per premium dollar, while for insured with low scores, the company paid a dramatic $1.15 in losses per premium dollar!

From government studies to private studies to insurer data, the predicative value of credit-based insurance scores has been repeatedly confirmed. They allow for dramatically improved underwriting for those insurers who use them and that benefits all insureds in that it allows for premiums to more accurately reflect risk. Consumers with poor credit scores can improve that score through positive action completely within their control. Consequently, credit-based insurance scores are predictive, objective and capable of change through positive conduct.

4. Has the use of credit-based insurance scores affected the price and availability of automobile and homeowners insurance? We are especially interested in evidence containing estimates of the size of such changes. Have some groups of consumers experienced cost reductions while others have experienced cost increases? If so, which consumers have experienced reductions and which have

[2] "Pure premium" is loss related only in this insurer's model.

experienced increases, and what are the magnitudes of those changes? Have some consumers experienced dramatic increases in their insurance premiums, solely as the result of the introduction of credit-based insurance scoring? If so, what has been the impact of this rise in premiums on these consumers?

Due to antitrust laws, we cannot comment on company-specific pricing practices, except as is otherwise public, but can say that increasing the number of predictive factors by which a company can rate a risk will allow that company to more accurately price that risk. Credit-based insurance scoring enhances this process.

The use of credit-based insurance scores has lowered the price of coverage for low-risk consumers. In general, it has increased the overall availability of automobile and homeowners insurance because it has increased confidence that insurers have in predicting losses. That increased confidence has encouraged insurers to offer coverage and compete in market segments that they were reluctant to compete in previously.

As expansively discussed in the response to question 3, insurers using credit-based insurance scores uniformly point out that the more accurate premium pricing they derive from scores allows them to write more business. For example, prior to scoring, one AIA company reports that it was primarily a writer of so-called "preferred risks," with a small amount of standard-type business. That same company estimates that it could quote only about approximately 60% of its total auto insurance applicants at that time. However, by using credit-based insurance scores, and the broader pricing range it has created, this company now can offer quotes to over 95% of ***ALL*** auto applicants in most states. Another AIA member reports that, since the adoption of credit-based insurance scores, it is now able to offer approximately double the percentage of applicants coverage that it used to offer coverage to before the use of insurance scores.

The same affidavits filed in the Michigan litigation referred to above show that credit-based insurance scores do afford most insureds substantial discounts on insurance that were previously not available. As a result of that litigation, numerous insurers have calculated the potential effect of a ban on their business.

One insurer estimates that 59% of its Michigan personal auto insureds will receive premium increases (2% to 13%), while 41% will get premium decreases (8% to 12%) if there is a ban. That insurer estimates that 59% of its Michigan homeowner insureds receive insurance score discounts, and that, 24% of these insureds will get premium increases (5%-11%), 41% will see premiums decrease 5%, and 36% will see no change if there is a ban.

Another insurer estimates that 84% of its Michigan homeowner insureds get insurance score related premium discounts, and that 48% of its homeowner insureds will see premiums increase (1% to 24%), while 52% will see premiums decrease (5.1% to 19.2%) if there is a ban. This insurer also estimates that 77.5% of its Michigan personal auto insureds receive an insurance score discount, and that 39% of auto insureds will see premiums increase (2.4% to 23.6%), while 61% will see premiums decrease (7.1% to 9.9%) if the ban proceeds.

Yet another insurer involved in the Michigan litigation estimates that 96% of its auto insureds there receive insurance score discounts on their premiums. It further estimates that 63.3% will likely experience premium increases averaging $171, while 36.7% will experience premium decreases averaging $295 if there is a ban.

A final insurer in this litigation estimates that 91% of its Michigan homeowner insureds and 89% of its auto insured receive discounts on their premiums because of scores. It further estimates that 68.1% of its Michigan homeowners' customers will experience premium increases while 31.9% will see decreases, and that 43.5% of its Michigan auto insureds will experience premium increases while 56.5% will receive decreases if there is a ban.

There is further, anecdotal evidence supporting the conclusion that insurance scores lower premiums. For example, there has been a simultaneous drop in the number of insureds getting coverage from automobile residual markets created by the states with the introduction and use of credit-based insurance scores. See Answer to Question 17 below. In Missouri, the number of policies insured through the assigned risk plan declined from nearly 9,000 in the late 1980s to approximately 300 in 2002, indicating much greater insurance availability in the major urban areas of Kansas City and St. Louis. Moreover, these residual mechanisms are usually priced so that they do not effectively compete with the voluntary market. Consequently, one can argue that price and availability have both been improved by the use of these scores, given the drop in residual market insurance consumers.

It is the underlying cost of claims that drives the price of insurance. The cost of claims on a macro basis determines the price of insurance on a macro basis. The risk assessment of various relevant factors, whether territory, credit-based insurance score, or something else, helps determine how a particular customer's premium will be impacted. It could be higher or lower, compared to some norm (the "norm" being defined as the overall average premium level needed to pay claims and cover expenses with a reasonable level of profit).

This question seems to address two issues which are related although that may not be apparent on the surface. These issues are "market availability" and "price ranges" or differentials. To the extent companies have a more accurate way of measuring risk for various groups of customers, the possible range of prices from high to low will increase, and the overall market availability can also increase. The decrease in insureds in the auto residual markets bares this out.

The magnitude of credit's impact varies by company, but various studies have shown that it isn't unusual for auto books of business to show loss cost differentials of 2 to 1, from best to worst, while homeowner's books sometimes show a 3 to 1 spread. Homeowners insurance does not have the same level of detailed rating sophistication for the customer that exists in auto. In both cases, however, credit-based insurance scores remain at the top of characteristics that can predict loss.

Undoubtedly some customers have seen price increases due to the introduction of credit-based insurance scores while other customers have enjoyed price decreases. Moreover, ban the use of credit will have a similar effect, in that some insureds will pay more and some insureds will pay less. These are logical results of the availability or unavailability of a powerful tool allowing insurers who use them to measure risk more precisely and price it accordingly. This allows insurers' premiums to take on a greater and more accurate range for the insurers who include this in pricing, while resulting in greater overall market availability. The net effect of this is that subsidization, whereby some insureds underwrite the premiums of others, is limited because the use of more equitable premium pricing that scores allow enables premiums to more accurately reflect risk for those insurers who use credit-based insurance scores. As actuary Mike Miller recently observed with respect to insurers using credit scores, "The knowledge that credit-based insurance scores are related and predictive of insurance losses, means that rates established without reflection of credit scores will be inadequate for some insureds, excessive for other insureds, and unfairly discriminatory for all."

5. How has the use of credit-based insurance scores affected the costs of underwriting and rating and/or the time needed to underwrite and rate?

Due to antitrust laws, we cannot comment on company specific pricing practices or costs, but can say that we understand the effect of insurance scoring has greatly enhanced the speed by which an applicant or customer can get a response from their insurer. As TransUnion states on its Web site: "The modern credit reporting system helps credit grantors approve loans and credit in minutes. Credit reporting also allows banks to issue credit cards to consumers who live across the country. The system provides continuously updated information to make fast, accurate decisions dealing with almost all consumer credit transactions." Because it allows for a quick, yet objective, analysis of reliability and risk, credit-based insurance scores speed the underwriting process and reduce the cost of more intensive, research-driven underwriting. This helps to reduce underwriting costs and, consequently, helps to promote lower costs in insurance.

We all know that information technology came of age during the 1990s. The 60-day underwriting period that exists in most states came about decades ago, when information traveled at the rate of the U.S. mail, and report and record ordering, gathering and analyzing could be a labor intensive, time consuming process. In those days, insurers necessarily had to employ many underwriters to review each and every application, record, report and other information to make decisions. This was obviously a time consuming and expensive process. Customers and agents might not know until weeks later. Also, the process was subject to the individual judgments and training of the underwriter.

Conversely, scoring models enable the process to be largely real time and objective. One AIA member company estimates that using credit-based insurance scoring models allows it to issue four to five times the number of policies per month that it could evaluate just six to seven years ago (and before it started scoring) with about half the underwriting staff it had at that time. As important as the efficiency, which over time translates into lower prices in a competitive market, the objective consistency of the risk evaluation may be even more important.

6. How has the use of credit-based insurance scores affected the accuracy of underwriting and rating decisions? Have the sizes of such changes been estimated and reported?

Due to antitrust laws, we cannot comment on company-specific underwriting or pricing practices but numerous studies by insurance regulators, universities, independent auditors and insurance companies, including a Dec. 2004 Texas Department of Insurance study, a June 2003 study of more than 2.7 million auto records by EPIC Actuaries and a Feb. 2003 Alaska Division of Insurance study, have all shown that an individual's credit history is a proven, strong indicator of how likely that person is to file a future claim.

Moreover, as already examined in the answers to Questions 4 and 5, the use of credit-based insurance scorers has improved and sped underwriting and rating decisions. One company reports substantial improvements in turn around time (four to five times more policies per month) with half the underwriting staff of just six to seven years ago.

Credit-based insurance scoring has enabled insurers to charge more accurate and equitable rates than they were previously able to offer. Because scores have been proven to be demonstrably correlated with risk, insurers' use of insurance scores has enabled them to more accurately segment their business and charge premiums commensurate with demonstrable risk. Without scores, insurers would have to revert to charging an identical rate for classes of business that present the insurer with different exposures to loss.

7. Has the use of credit-based insurance scores affected the amount of automobile or homeowners insurance purchased by consumers?

More accurate premium pricing, which credit-based insurance scores permits, allows insurers to write more business (as examined in Questions 4 to 6 above) so presumably more insureds are able to obtain insurance, although we are unaware of any specific studies on this issue. There is, however, anecdotal evidence supporting this conclusion. For example, there has been a simultaneous drop in the number of insureds getting coverage from automobile residual markets created by the states following the introduction and use of credit-based insurance scores. Moreover, these residual mechanisms are usually priced in a way to not discourage the voluntary market; i.e., they are priced so that they do not effectively compete with the voluntary market. Consequently, one can see that price and availability have both been improved by the use of these scores, given the drop in residual market insurance consumers.

Moreover, notwithstanding the use of these scores, there is no availability problem, as the rate of homeownership demonstrates. Mortgage companies require homeowners to maintain insurance on the property; that is a universal fact. With home sales and homeownership at an all-time high, and homeownership among minority groups, alleged by some to be the "targets" of credit-based insurance scores, also at all-time highs, availability problems due to the purported restrictive nature of these scores appear to be non-existent.

The US insurance market is made up of more than 3,300 insurance companies in the United States (as of 2002), writing more than $400 billion in property/casualty insurance premium. Insurance is a highly competitive industry and insurance products are widely available for a wide array of prices based on service, coverage, and other consumer needs.

Has it affected the limits or deductibles that consumers select when purchasing automobile or homeowners insurance?

Due to antitrust laws, we cannot comment on company-specific pricing practices. Nonetheless, it is our understanding that insureds select their own limits and deductibles, unless states obligate, as they often do certain amounts.

Notwithstanding the insured's ability to select limits and deductibles, one AIA member company reports that, in comparing results from old and new class plans where the new plans include insurance scores, there is some evidence that higher limits of liability coverage <u>and</u> lower physical damage deductibles are being purchased in the new plans.

Has it affected the number of drivers who drive without insurance?

As already noted, the timing of the decline in insureds getting coverage from automobile residual markets, tracking as it has with the introduction and use of credit-based insurance scores, is at least anecdotal evidence of the broadening of insurance availability attributable to these scores. Still, to our knowledge, there are no definitive studies on uninsured motorists and the reasons <u>why</u> they drive without insurance. It may well be overly simplistic to assert that a lone rating factor such as credit-based insurance scores is the reason people drive without insurance – there could be dozens of reasons – social, cultural, and financial, among others. Moreover, in representing auto insurers before regulatory authorities, AIA has become aware of regulatory-reporting problems caused by well-intentioned, yet poorly executed, plans to reduce the number of uninsured vehicles that may actually exacerbate the problem. Notwithstanding the foregoing, a scientifically sound study of uninsured motorists may be helpful in shaping public policy and may allow insurance companies to compete for more of this market.

Has it affected the number of homeowners that have no homeowners insurance?

Again, insurers uniformly believe that more accurate premium pricing, which credit-based insurance scores permits, allows them to write more business. Also, as noted above, with record homeownership numbers and the universal requirement among mortgage companies that homeowners have insurance, any true availability problem caused by the use of these scores would be widespread and would have certainly revealed itself some time ago.

What are the estimated sizes of such changes?

We are unaware of precise figures on the increased numbers of insureds resulting from the use of credit-based insurance scores.

8. How has the use of credit-based insurance scores affected the cost and availability of automobile or homeowners insurance to consumers with poor credit histories?

While at first glance it may appear that the use of credit-based insurance scores has increased the cost of automobile or homeowners insurance for consumers with poor credit history, a review of the market dynamics suggests that possibility is rather unlikely. It is true that, absent other considerations, the use of credit-based insurance has increased the quoted price for risks with poor credit relative to the price quoted prior to the use of credit for a risk that met the underwriting acceptability standards. But it is quite likely that the poor credit risk would not have met the previous underwriting standards and would not have been quoted a price at all prior to the use of scoring. Poor credit risks often fall into the higher risk segment of the market. Previous to the use of credit, few standard carriers would compete for the higher risk segments of the market. This limited competition certainly generated increased prices for these market segments. Vigorous competition was limited to the preferred segments. With the use of credit-based insurance scores, standard carriers are now vigorously competing for virtually all segments of the market. This more vigorous competition certainly is working to lower prices for the higher risk segments.

In fact, the numbers bear out that consumers have more, not less, choice in the voluntary market as a result of the use of credit-based insurance scores. This has improved risk assessment and pricing and allowed for more consumers to be underwritten who in the past may have been rejected. More detailed responses that confirm both better pricing and increased availability as a result of these scores can be found above in answers to Questions 4 to 7.

Moreover, insurance scores are not the whole story when it comes to rating and pricing insurance. As one member explained, a poor insurance score does not necessarily equate to a bad risk and a higher premium, because insurers typically do not use credit in isolation. It is the interaction of credit with other underwriting variables that helps establish company or tier placement. For example, two applicants with identical insurance scores but different claims records might not be in the same rating tier. Alternatively, two applicants with significantly different insurance scores might be in the same rating tier, depending upon their other underwriting characteristics.

What effect has it had on the purchasing of automobile or homeowners insurance by consumers with poor credit histories?

To our knowledge, there are no studies or other information on any "effect" on the insurance purchasing habits of consumers with "poor" credit histories due to credit-based insurance scores, but again, the level of competition in the marketplace today provides consumers of all risk profiles many choices for insurance. As already examined above, however, because credit-based insurance scores have resulted in better pricing accuracy, they have increased insurance availability. That has allowed more individuals to obtain insurance.

9. Has the use of credit-based insurance scores affected the cost and availability of automobile or homeowners insurance to consumers with no credit history? If so, how? What effect has it had on the purchasing of automobile or homeowners insurance by consumers with no credit histories?

Due to antitrust laws, we cannot comment on company-specific underwriting or pricing practices. According to some credit bureau statements, there are more than 220 million active credit consumers in the United States today. We are unaware of any studies on the small subset of insurance consumers with no credit history. On those limited occasions when a person does not use credit in any way today and does not have a credit record, many states, like the twenty-four that have adopted the National Conference of Insurance Legislators Model Act on Credit, provide legal guidance to avoid undue harm caused by this unique situation.

Since insurers typically do not consider credit in isolation, the lack of credit history is considered in combination with other factors to assess risk. It is the interaction with other variables that helps establish company or tier placement. For instance, two applicants with no credit history but different claims records might not be in the same rating tier

10. How has the use of credit-based insurance scores impacted the availability or cost of insurance to consumers by geography, income, ethnicity, race, color, religion, national origin, age, sex, marital status, or creed?

Again, due to antitrust laws, we cannot comment on company-specific underwriting or pricing practices. Nonetheless, this is not the correct question because it assumes that all of these characteristics are legally precluded in their entirety. This is simply not the case. For example, gender, marital status, geography and age are all permissible rating factors under the law in the vast majority of states. Therefore, it must be kept foremost in mind that while ECOA classes contain some elements that insurers are prohibited from considering in their evaluation of risk in any way, other characteristics are legitimately part of approved rating plans and may be considered. To underscore this distinction, we prefer "protected status data" to ECOA data.

We can categorically state that insurers do not collect any "protected status data" as discrimination based on those factors is illegal. Credit-based insurance scores are "blind" – they <u>never</u> factor in "protected status data" – and are applied equally to applicants and/or insureds.

Moreover, one AIA member company has reported that, for those ECOA factors that are legitimately used in rating (e.g. rating territory (geography), age, gender, marital status), it does not believe it has seen any adverse change that can be attributable solely to the use of scoring, though it is seeing increasing numbers of customers with various measures of these factors. Again, this seems to underscore that rather than having a negative effect, the use of scoring is having a positive effect on the overall availability of insurance as seen through the inclusion of more diverse applicants.

A January 2003 study by the Alaska Division of Insurance seems to confirm this positive effect on overall availability, more diverse insureds and lower prices. The study on how the use of credit-based insurance scoring impacted Alaskan auto insurance consumers indicated that following the advent of credit scoring in the state, more Alaskan consumers were placed in standard or preferred rating categories and fewer consumers were placed in the highest cost or non-standard categories than prior to the use of credit scoring. The declines in the number of consumers placed in non-standard rating categories, including those geographical areas with higher numbers of ethnic minority and lower income consumers, were quite consistent and substantial following the implementation of credit scoring. For example, three rural zip codes in Alaska with high percentages of non-white and lower income residents, saw declines in percentages of policyholders placed in non-standard rating categories from 36% to 15%, 22% to 15%, and 29% to 16%. In fact, the most dramatic declines in non-standard business and the placing of more consumers in standard or preferred categories after credit scoring took place in areas of Alaska with higher percentages of ethnic minorities and lower-than-average incomes.

The Alaska study found no indication that lower-income consumers were disadvantaged by credit scoring. In fact, the study found that one of the state's highest income zip codes had more people in substandard rating classes and fewer in preferred or standard categories. Credit scoring critics claim that the use of this tool is unfair to lower-income consumers and rewards high-income consumers. This claim was contradicted by the Alaska study.

What are the estimated sizes of such changes for each of the above categories?

Since insurers do not track protected status data, they do not have data about any changes in these categories. Nonetheless, the immediately proceeding discussion of the Alaska study demonstrates positive and substantial changes after the introduction of credit-based insurance scoring.

11. To what extent does consideration or lack of consideration of certain factors by credit-based insurance scoring systems result in negative or differential treatment of protected classes of consumers, that is, the same categories of consumers against whom discrimination is prohibited under the ECOA (e.g. race, color, religion, national origin, sex, age, and marital status)?

As stated previously, to discriminate based on "protected status" is already illegal and insurers simply do not do it. Nonetheless, at least one insurer has reported more diversity in applicant characteristics that are acceptable for underwriting since the inception of insurance scores, something the Alaska study discussed above also confirmed.

Moreover, the EPIC actuarial study found a consistently strong relationship between insurance scores and future auto losses in all states and Washington, D.C. Although circumstantial, this is a relevant finding that credit-based insurance scores do not produce a negative or differential effect for protected classes of insureds because there are substantial variations among the states with respect to the percentage of minority populations and household income. Insurance scoring was found to be as powerful a predictor of future risk in states with low-percentage minority populations, such as Utah, Idaho, Iowa, and Montana, as it was in states with high-percentage minority populations, such as New York, Maryland, Washington, D.C., Alabama, and Mississippi. If some insurers were attempting to use scoring as a proxy for prohibited factors such as race and income, as some critics have alleged, one would not expect to find such a strong and consistent relationship, or it might be a rating tool used in some states and not in others. Instead, insurers are advocating use of insurance scoring, with reasonable regulatory oversight, in all states.

In addition, the EPIC study thoroughly explored the question of potential "overlap" between insurance scoring and other rating factors, including age, gender, and rural, suburban, and urban rating territories. Insurance scoring was an important predictor of risk, even after fully adjusting for other rating variables such as territory, indicating that scores are picking up an independent risk factor. This is an important finding with respect to impact on urban areas, which tend to have higher minority and low-income populations. Because insurance scoring assesses an element of risk that is not measured by territory and other factors, its use is helping to make the rating process more accurate and fair in urban, rural and suburban areas alike.

12. To what extent, if any, could the use of underwriting systems relying on credit-based insurance scoring models achieve comparable results through the use of factors with less negative impact on consumers in the ECOA protected categories?

The question assumes that underwriting systems that utilize credit-based insurance scores have a negative impact on consumers in the ECOA-protected categories. Such a conclusion has not been demonstrated and the question is biased and objectionable as worded.

Insurers continue to seek new and creative rating variables to enhance the current set of rating variables (including credit). Because credit can be segmented into very narrow risk categories, it has enabled carriers to develop sophisticated rating plans that more accurately price individual risks. The use of credit-based insurance scores has allowed insurers to transition, in their underwriting practices, from rather large groupings of individuals with similar risk characteristics to much smaller groupings of people with risk characteristics that are much more closely matched. This has resulted in more accurate and equitable pricing, on an individual risk basis, and has allowed insurers to write a broader spectrum of risks.

For those insurers using it, it is their view that no other rating variables "known" today lends itself to risk segmentation to the same extent that credit does. As previously noted, these scores are blind to "protected status" factors and applied evenly to potential insureds. Also see our responses to questions number 1 and 3. As Mike Miller, one of the authors of the EPIC study recently observed:

"No single risk factor has yet been discovered which alone can measure the totality of risk presented by an individual auto insured. Our study of June 2003 found that credit-based insurance scores are among the three most important risk factors for each of the six automobile coverages studied. We further found that by introducing credit-based insurance scores, there was a significant increase in the accuracy of the risk assessment process."

Mr. Miller subsequently concluded that, for insurers using scores, "The knowledge that credit-based insurance scores are related and predictive of insurance losses, means that rates established without reflection of credit scores will be inadequate for some insureds, excessive for other insureds, and unfairly discriminatory for all."

The EPIC study also adjusted for any overlap amongst credit-based insurance scores and other variables. It concluded that, after accounting for the overlap, credit continued to be a very significant predictor of risk. Indeed, the second finding of the study states: "Insurance scores do overlap to some degree with other risk characteristics, but after fully accounting for all interrelationships, insurance scores significantly increase the accuracy of the risk assessment process."

Thus, credit-based insurance scores add independent value beyond other factors now in use. So, for example, in urban and other areas where there may be concentrations of consumers in ECOA-protected categories, credit scoring adds accuracy and refinement in rating over the impact of territory alone.

A significant number of such consumers would see benefits, including better rates and more competition among carriers, than would be the case if only territory and other longstanding rating variables were used. In other words, credit scoring can modify the impact of underwriting variables over which consumers have less control, including the important variables of location, gender, and age. As consumers have much more control over their own credit scores, the use of credit scoring can benefit those consumers who might pay higher rates due to age, gender, or location in a congested area with high loss experience.

13. What steps, if any, do score developers or insurance companies take to ensure that the use of credit-based insurance scores does not result in negative or differential treatment of protected categories of consumers listed in the ECOA?

The question also assumes that underwriting systems that utilize credit-based insurance scores have a negative impact on consumers in the EOCA-protected categories. Such a conclusion has not been demonstrated and the question is biased and objectionable as worded.

Again, credit-based insurance scores are objective, blind to "protected status" factors and applied evenly to potential insureds. In addition, the models are open for regulator review and the resulting rates are regularly filed for approval pursuant to state insurance and anti-discrimination laws. If a score or factor is predictive for loss, it is of value to an insurer attempting to assess risk. If technical guidance on how this is achieved is being sought, score developers and modelers would be in the best position to answer this question.

Have score developers or insurance companies changed the way credit-based insurance scores are developed or used in order to avoid negative or differential treatment of protected categories of consumers listed in the ECOA?

Due to antitrust laws, we cannot comment on company-specific underwriting or pricing practices, but insurers apply credit-based insurance scores evenly to all consumers and, as already noted, these scores are not based on protected status data. Consequently, how can the data be adjusted to not capture something insurers are already not capturing? If technical guidance is being sought, score modelers and developers are in the best position to answer these questions.

Are any particular credit history factors not used because of actual or potential negative or differential treatment of protected categories of consumers listed in the ECOA? If so, what are they?

It is our understanding that that credit bureaus and score developers neither collect nor have protected status data. Score developers and modelers could also answer this.

14. Has the use of credit-based insurance scores caused a change in the method and amount of pre-screening consumers for insurance offers? What effects has this had on the terms offered to consumers?

Due to antitrust laws, we cannot comment on company-specific underwriting or pricing practices. In terms of the property and casualty insurance industry, we are unaware of whether any study has been undertaken of this and, if so, are not familiar with the results. If the effect on the amount of underwriting is being sought, please see the answer to Question 5 above. As the responses to Questions 4 to 7 demonstrate, scoring has substantially increased the amount of insurance solicitations being made by various insurers. In this way, market availability and competition have been substantially increased.

Because insurance scores correlate so significantly with risk of loss, we do understand that some insurers include insurance scores as a criterion for prescreening consumers for insurance offers as permitted by law. In accordance with federal law, a firm offer allows these insurers to apply their other underwriting criteria when the applicant requests a quote. In these situations, insurers apply the same underwriting criteria to a prescreened application as they do to any other consumer-initiated application, in accordance with state laws. The actual price terms offered will depend upon the combination of insurance scores with other underwriting and rating criteria, but the fact that prescreened credit was used makes no difference to the consumer. These insurers believe that the use of prescreened credit enables them to more efficiently apply their marketing dollars in a targeted manner to consumers that are most likely to be good insurance risks when measured by their underwriting criteria.

15. How has the use of credit-based insurance scores affected companies' ability to enter new lines of the automobile or homeowner's insurance business?

Due to antitrust laws, we cannot comment on company specific underwriting or pricing practices. As described above, it has allowed insurers to expand available insurance within these lines by more accurately pricing for risk. One member does report that it was an impetus to entering the motorcycle market.

16. If the use of credit-based insurance scores has affected the costs individual consumers pay for insurance, has it (i) caused a change in the overall average cost of insurance for consumers?; (ii) changed the distribution of individual costs?; or (iii) caused any other change in the costs to consumers? What are the magnitudes of any such changes?

This question has been addressed in various ways by preceding responses. Though we cannot comment on company-specific underwriting or pricing practices due to antitrust laws, we know that credit-based insurance scores allow insurance companies to better match price with risk because it improves the risk assessment process. In this way, these scores allow a company to greatly expand their market reach. In addition, we understand that for most insurers this expansion has come on so-called "standard" down through "nonstandard" markets. Consequently, credit-based insurance score bands will affect these markets greatest.

In addition, one AIA member has reported that the use of insurance scores in underwriting has been revenue neutral. Nonetheless, it has allowed insurers to provide more accurate, fair and equitable segmentation of risk.

17. Would an analysis of the share or number of consumers that purchase automobile or homeowners insurance from "involuntary," "pooled risk," "assigned risk," or other types of insurance other than insurance offered on a voluntary basis by private insurers, be informative about the price and/or availability of automobile or homeowners insurance?

Please see our response to Question 7. Such a study may indicate some correlation between the change in the size of residual markets and the introduction of credit-based insurance scoring. We do believe such an analysis could be informative.

The development, introduction and expansion in the use of credit scoring from the late 1980s to the early 2000s also coincide with a period of time when the number of auto policies insured through the assigned risk or markets of last resort saw a steady and rather dramatic decline. There are several other factors besides credit scoring that may have also contributed to this decline. These include greater highway and vehicle safety and a lessening of claim fraud and claim padding. Indeed, many insurers have noted that scoring has enabled company underwriters and actuaries to serve a wider market and become more competitive in urban markets through more accurate rate quotation and pricing. For example, in Missouri, the number of policies insured through the assigned risk plan declined from nearly 9,000 in the late 1980s to approximately 300 in 2002, indicating much greater insurance availability in the major urban areas of Kansas City and St. Louis.

On a national level, declines in assigned risk policies have also been impressive during the period of time that credit scoring became more widely utilized by insurers. In 1994, there were nearly 6 million policies insured through assigned risk plans, according to AIPSO. By 2001 this number had dropped to 2.49 million policies, a decline of nearly 60%. Also, assigned risk policies dropped from about 7% of the private passenger market to less than 2%.

Therefore, there is at least anecdotal evidence supporting the conclusion that the decline in residual markets is informative of the benefit of these scores in pricing risk. For example, there has been a simultaneous drop in the number of insureds getting coverage from automobile residual market with the introduction and use of credit-based insurance scores. Moreover, these residual mechanisms are usually priced so that they do not effectively compete with the voluntary market. Consequently, there is substantial reason to believe that price and availability have both been improved by the use of these scores, given the drop in residual market insurance consumers.

Would an analysis of the share of drivers that drive without automobile insurance be informative about the price and/or availability of automobile insurance?

As stated in our response to Question 7, to our knowledge, there are no definitive studies on uninsured motorists and the reasons <u>why</u> they drive without insurance. It would likely be overly simplistic to think that a lone rating factor such as credit-based insurance scores is the reason people drive without insurance – there could be dozens of reasons. In addition, in representing the auto insurers before regulatory authorities we have become aware of procedural reporting problems caused by well intentioned, yet poorly executed, plans to reduce the number of uninsured vehicles that may unintentionally exacerbate the problem. Notwithstanding the foregoing, a scientifically sound survey of uninsured motorists may be helpful in shaping public policy and helping insurance companies capture some of this market. An analysis of residual markets and the share of the uninsured drivers/homeowners from the period prior to the use of credit-based insurance scores could be very informative about the price and/or availability of automobile or homeowners insurance. Because many factors impact residual and uninsured markets, these factors would need to be controlled for in the analysis.

18. What impact, if any, does banning or limiting the use of particular underwriting or rating factors, such as gender, territory, or credit-based insurance score, have on the price or availability of automobile or homeowners insurance?

While we cannot comment on specific price or availability actions by insurers, logic and practice confirm that limiting legitimate rating factors in evaluating risk also limits an insurer's ability to more accurately evaluate and price that risk. "Protected status factors" discrimination is not part of pricing insurance or credit-based insurance scores.

The goal of actuarial science is to produce a rate for each insured that most accurately reflects the risk that the insured presents. That is, the rate should be as equitable as possible. This goal is codified in the Casualty Actuary Society's "Statement of Principles Regarding Property and Casualty Insurance Ratemaking", specifying that a rate should not be "excessive, inadequate, or unfairly discriminatory." Banning any loss-predictive variable--be it territory or insurance score--creates a situation in which the resultant rate is by definition either excessive or inadequate. With respect to credit-based insurance scores, the resultant rate for those with below-average credit is inadequate while the rate for those with above-average credit is excessive. In either case, the result is incongruent with the Statement of Principles, and therefore, actuarially unsound.

A prohibition of a predictive rating or underwriting variable would inhibit insurers' ability to charge the right rate for the risk. As the effects of a ban began to impact insurer financial results, those insurers will either be forced to raise rates for all insureds (thereby exacerbating adverse selection) or begin to tighten other underwriting guidelines for the high-risk portion of their portfolios. Insurers find neither of these options to be acceptable.

Because of the adverse consequences discussed, banning any predictive rating or underwriting variable will affect the insurance market, will intuitively slow the rate of new entrants into the personal lines market in a state and possibly reduce availability, will increase expenses for insurers who attempt to stay in the market and reprogram their underwriting or rating systems to comply with a state's unique requirements, and will shift the cost of insurance products from a smaller percentage of high-risk consumers to the larger population of low-risk consumers. An outright ban on credit-based insurance scores is an extreme – and harmful – "answer" to concerns about the practice of insurer use of credit information. Policymakers should consider reasonable measures, such as the NCOIL model law, which preserve the proven benefits of credit-based insurance scores while protecting consumer interests.

Has the prohibition on the use of credit-based scores for insurance in particular states had any impact on the price or availability of automobile or homeowners insurance for consumers in those states? If so, what has that impact been?

Maryland is the only state that has legislatively banned the use of credit information by insurers, and that is only for homeowners insurance. The Maryland ban has had a negative effect on that market, and has resulted in consequences that were neither intended nor expected by supporters of the ban. For example, individual insurers have reported the following:

- Rates have had to be increased by a higher margin than if the ban had not been in effect.
- The writing of new business has been curtailed.
- Concerns about being unable to collect adequate premiums have heightened in the absence of highly predictive, beneficial credit information.

- Company costs have increased as necessary systems changes have been implemented. One company reported that complying with the ban has cost it more than $400,000.
- At least one company was forced to eliminate its most preferred rating tier, causing its lowest-risk customers to pay more in premiums.
- Rates for 59 percent of one company's policyholders were forced upward by 14 percent.
- Rates for one company's homeowners insurance increased up to 25 percent.
- At least one company that was prepared to enter the Maryland homeowner's insurance market has reported that it declined to do so after the credit ban.

We expect a similar disruption in Michigan if the challenged ban proceeds there.

Conversely, New Jersey has recently permitted some insurance companies to begin using credit-based insurance scores. Subsequent to those regulatory moves, we have witnessed several companies willing to enter the New Jersey personal auto market, presumably due to the increased ability to accurately price the personal auto product.

Studies by insurance regulators, universities, independent auditors, and insurance companies all have shown that an individual's credit history is a proven, strong indicator of how likely that person is to file a future claim. Claims costs, not credit-based insurance scoring, drive premium increases. Banning such a predictive tool from insurance underwriting and rating clearly is the wrong public policy decision and, based on Maryland's experience, will unfairly disrupt and skew the marketplace.

If the use of credit-based insurance scores was not allowed in additional states, what impact would this have on the price or availability of automobile or homeowners insurance?

Please see the immediately proceeding response. We believe the consequences of a ban will be the same in any state that adopts one.

Are there, or would there be, any specific effects on those insurance consumers who are within protected categories listed in the ECOA?

Please see responses to Questions 12 and 13. As a practical matter, however, we would expect that such a ban will negatively affect all consumers of insurance, regardless of race, ethnicity, etc., who possess a better credit-based insurance score, because it will eliminate that variable from pricing risks.

19. How are records of inquiries used by credit-based insurance scoring systems?

We understand that all scoring models evaluate inquiries in the following ways. "Hard" inquiries – those when a consumer proactively is seeking to get credit, like applying for a loan or credit card – are used in calculating scores because they directly relate to risk. "Soft" inquiries – those when, for example, a credit card company reviews a credit report to make a firm offer of credit as permitted by the Fair Credit Reporting Act – do not get calculated by scoring models. Consumer inquiries never count against a consumer in their score and many scoring models recognize "comparison shopping" when, for example, a consumer has four to five inquires in a short span of time from auto dealers without getting four to five loans. That is recognized as one inquiry for an auto loan because the consumer was clearly seeking the best rate.

Moreover, the models underlying credit-based insurance scores typically ignore items that are coded on the credit file as under dispute. Thus, inquiry information that is identified as potentially inaccurate is not reflected in the score. Other steps to improve accuracy in scoring are also taken, for example, with respect to consumers who have been victims of identity theft. One AIA member has informed us that it has implemented a procedure under which the consumer in these circumstances is not penalized. The rating selects from the highest of the individual's actual scores and the average score for all consumers to provide the better rate of the two score possibilities. We imagine that other AIA member companies have taken similar steps to improve the accuracy of credit scores, inquiries, etc. Nonetheless, score developers and modelers are best positioned to answer these technical questions.

It is worth noting that the National Conference of Insurance Legislators (NCOIL) model law on credit scoring has been adopted in 26 jurisdictions. The NCOIL "Model Act Regarding Use of Credit Information in Personal Insurance" provides clear rules for the industry and the use of inquiries and prohibits the negative use of some inquiries for underwriting and rating.

Does concern about the possible effects on their credit-based insurance scores affect consumers' insurance-shopping behavior? If so, what impact does this have on competition in the insurance markets?

We are unaware of any studies on this subject. These questions are hard to answer because it would be speculating on the mindset of millions of consumers regarding their shopping habits. Still, it seems highly unlikely that a consumer would place the possible effects of a change in a single rating factor, such as credit-based insurance scores, that might result from value shopping above concerns for coverage, price, service and reputation of the insurer they seek to contract with. By analogy, credit inquiries certainly do not seem to affect shopping for automobiles.

C. <u>Conclusion</u>

In the final analysis, numerous studies confirm the actuarially soundness and propriety of credit-based insurance scores in assessing risks and premiums, as well as their "color blind" attributes. The foregoing responses underscore these findings--credit-based insurance scores are reliable and beneficial to insurer and insured alike. In the limited places credit bans have been imposed, consumers have been harmed because insurers can no longer use this valuable tool in properly setting premiums and accepting risks.

Again, AIA appreciates the opportunity to provide these comments. We look forward to continuing to work with the FTC as it studies the use of credit-based insurance scores and welcome any additional questions or follow up you may have.

Respectfully submitted,

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